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SUBJECT: Speaker's views on Anti-corruption, Money
Laundering and Windfall Profit Tax Legislation

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¶1. (SBU) Summary: During the Ambassador's May 24 call on Speaker Nyamdorj, he expressed his firm support for the windfall profits tax passed by the State Great Hural (parliament), and opined that the body may override a veto if the President chose to take that step. Companies that expected to earn high profits without any work might have complaints, but they should realize those high profits were being made from Mongolia's soil and the Mongolian people. Nyamdorj said he had initially been dismissive of complaints about mining by demonstrators, but had been persuaded there are many problems. Nyamdorj said that he is working toward passage of tax reform before the July recess, and this should provide a favorable business environment. He also said he intends for the parliament to pass anti-corruption and anti-money laundering legislation before it adjourns. End summary.

¶2. (U) Ambassador met with Speaker Nyamdorj on May 24 for 80 minutes. Nyamdorj was accompanied by MFA Director General for the Americas, Middle East and Africa Jambaldorj. Nyamdorj noted that the spring session of the State Great Hural had a busy agenda, and would look at important laws in taxation, minerals, anti-corruption and anti-money laundering (AML). If it was able to pass the bills, Nyamdorj jested, the session could be considered the legislature's contribution to the country's 800th anniversary celebration. Nyamdorj said that he had looked at the papers that the Ambassador had sent in March on laws of interest to the United States. He had forwarded these to the various Standing Committees and hoped they would take note.

Ambassador Urges Passage of Laws

¶3. (SBU) The Ambassador responded that Washington is especially looking for anti-corruption, anti-money laundering and terrorist financing, and corporate tax legislation. Passage of good legislation would help the U.S. work better with Mongolia on its democratic

and economic development. There is a sense of urgency in Washington about Mongolian action on laws regarding money laundering, corruption, terrorist financing and tax reform. The Millennium Challenge Corporation (MCC) is looking at the anti-corruption legislation closely; passage of legislation which implements Mongolia's commitment under the UN Convention Against Corruption would demonstrate Mongolia's commitment. The Ambassador continued that there is high-level interest in Washington on North Korean illicit activities and money laundering activities. There is also concern that Mongolian banks, which are without AML controls, could be used by terrorists. Lack of AML controls had resulted in Mongolian banks having difficulty establishing correspondent relationships with U.S. banks. She noted that a senior U.S. Treasury official would visit Mongolia in early June to discuss the AML and North Korean activities. The Ambassador added that there is also concern in Washington about budget management by the Ministry of Finance and supervision of Mongol Bank. The Treasury Department is prepared to send a technical advisor to help the Ministry, and perhaps also to Mongol Bank. She asked Nyamdorj for his view of the situation and possible aid.

¶4. (SBU) The Ambassador noted that the Speaker had mentioned minerals and the tax law. The U.S. hoped for changes to the tax law that would help American businesses -- but such changes would also generally create more jobs and economic growth for Mongolians. She noted that the USAID-funded Economic Policy Reform and Competitiveness (EPRC) project had provided analysis to the State Great Hural on the various tax reform options; the project looked forward to

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continuing such assistance. Regarding the recent passage of the windfall profit tax, the Ambassador said, she had heard many complaints from both Mongolian and U.S. businessmen. They described the law as "shocking." Regrettably, the law seemed to have sent a negative message to all investors, not just those in mining. This was because it had sent a worrisome signal about the stability of the legal environment for business and about transparency of policymaking. Noting that the Democratic Party seemed to be saying it would not vote to override a veto, she asked the Speaker for his comments.

Speaker Defends Windfall Profit Tax

¶5. (SBU) Nyamdorj immediately responded that he would deal with the last issue first. This issue had become a public issue and sensation -- rather like immigration in the United States, he opined, which had also resulted in marches and public debates. There had been organized efforts to discuss the mining issue in the media, and provoke public attention. As to the windfall profit tax, the Speaker said, the historic cost basis for gold production is \$250 per ounce. Mongolia had said that, if world prices are more than \$500, a 68% tax would be imposed -- companies would continue to keep 32% above this high price. There was also a 68% tax on copper on prices in excess of the stated level. Nyamdorj smilingly noted that Mongolia had been very happy in May of 2005 at the "peak" price of \$2800 per ton. The Speaker said he did not know whether the President would veto the windfall profits law, but if he did that could be overridden by the State Great Hural and the law implemented. Regarding the Democratic Party, he said, he did not know if they would support the veto, but the bill had been introduced by their own members. Nyamdorj recalled that in 1998, during Enkhsaikhan's time as Prime Minister, the Democratic Coalition government had

introduced a windfall profits tax. However, then President Bagabandhi had vetoed it, and the Democrats had accepted the veto.

16. (SBU) When the price of metals goes up, Nyamdorj said, it should not be just one party enjoying the benefit -- neither the Erdenet copper mine (note: a Mongolian-Russian joint venture) nor private companies. Nyamdorj said he had read carefully the Ambassador's thoughts on how the 1997 mining law had been "perfect." He said he was now comparing the 1997 law to the 1994 law. He had asked a working group to review how mining licenses had been distributed. As he saw things now, Nyamdorj said, there had been many mistakes and misjudgments in implementing the 1997 law. All of the negative outcomes had been caused by the imperfect nature of the legislation. This had also led citizens to demonstrate and to the debate about new legislation. Nyamdorj cited two examples of problems with licensing. One person who was not even properly registered as a company owned 200 licenses. In 19 soums of one aimag, 50 mining licenses had been distributed in one day. Nyamdorj grimly jested that he felt sorry for the person who had signed all that paper on one day. Some 200 "companies" had obtained licenses by filing false documents. These were examples of why Mongolia needed to review the licenses and needed to act to prevent these problems in the future.

17. (SBU) The Speaker continued that lack of land rehabilitation on mining sites is also a problem. Moreover, the Speaker noted, when the international market price for coal is \$45 a ton, Mongolia was being told coal exports were priced at only \$10 a ton. All this explained the feeling there need to be changes to the law. However, Nyamdorj said, Mongolia also believed that principles should be observed and mining companies which operated properly should be allowed to continue. This position had been explained to demonstrators. All domestic and foreign investors

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should be treated fairly. Those companies getting profits from mining should obey Mongolian law.

18. (SBU) The Ambassador commented that one of the concerns of mining companies regarding the windfall profit tax is its relationship to tax reform. Mongolia also seemed to be considering abolishing tax holidays. There was concern that this was not being done as part of an overall tax package which would also contain offsets, for example deductions for business expenses as was being proposed in the tax law. If done as part of an overall package, the government could still ensure it gets appropriate revenues from the sector.

19. (SBU) Nyamdorj responded that there had been two alternatives put forward: increased royalty payments or a windfall profits tax. Mongolia had chosen the second option. As to why the bill had moved quickly, the SGH's schedule is tight, and the bill seemed very exact and easily understandable. There had been concern expressed by companies, who had been expecting to earn high profits without exerting any efforts. These companies should remember they earned those profits at the expense of Mongolia's soil and its people. Nyamdorj added that there were many debates over Oyu Tolgoi (note: an apparent reference to the copper mine being developed at the site by Canada's Ivanhoe Mines). He understood that it would be 7-8 years before production was at full scale. Prices might well drop considerably during this period. Nyamdorj added that he disliked attempts by companies, both Mongolian and foreign, to "intervene in state policy." Commenting that there had been many cases of corruption in government, Nyamdorj said he opposed these. Ambassador

asked him to clarify what he opposed, noting that of course corruption should be stopped. Nyamdorj reiterated that he opposes intervention by lobbying and bribing.

¶10. (SBU) Regarding environmental damage caused by mining, the Ambassador noted that she had recently visited a Rio Tinto mine in Alaska. The mine is situated in an environmentally protected area, and there are tight regulations on it from the federal, state and local governments. At the outset of mining, a set aside of funds had to be made to ensure the land was fully restored. She commented that it provided a good example of how effective regulation can ensure mining that respects the environment.

¶11. (SBU) Nyamdorj asked if the Ambassador had visited one of Mongolia's most notorious mining sites. He said that whenever he drives past it, he can't bear to look at it. All the excavated soil is still there, and is spoiling the Tuul River. His question is, "What price is the Tuul River worth?" When he had visited Utah, he had seen a copper mine using modern technology, and without damage to the environment. In Mongolia, however, the mining companies were causing a lot of damage; this should not be a problem if modern technology is used. Nyamdorj repeated his recommendation the Ambassador pay a visit to the mining site. The situation had led to considerable public upset. The Ambassador responded that she was aware of at least one local group opposed to the mining damage. Companies are not making an effort to rehabilitate the land, Nyamdorj said. "That's why I'm going to tell them to stop." Nyamdorj opined that countries like South Korea are able to reach high development without mining.

¶12. (SBU) Nyamdorj returned to the subject of the disparity in coal prices between world markets and what was claimed as the price on export from Mongolia. These companies are using false documentation to keep the profits outside Mongolia, he said. The Mongolian state and public could not turn a blind eye to this problem. This also raised questions of justice and fairness, and about Mongolia's fight against corruption. If these companies mine Mongolian coal,

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they should obey Mongolian law and pay Mongolian taxes. Otherwise, why should Mongolia allow export of its coal? Nyamdorj said he was being frank with the Ambassador because he knew he could do so and receive fair comments in response.

¶13. (SBU) The Ambassador responded that she also wanted to be frank. Mongolia could reasonably control speculation on mining licenses without any production. It should certainly protect the environment. She expressed concern, however, that the windfall profits tax and other things being discussed might result in driving away high quality foreign mining companies, which would pay taxes and protect the environment. She noted that such companies, from the UK, Australia and Canada are in Mongolia, but none from the U.S. As a result, Mongolia might be left with Russian and Chinese companies who would not play by international standards.

Speaker Hopes for Tax, Mining Law By July

¶14. (SBU) Nyamdorj said that he hoped the State Great Hural will finalize mining and tax laws before its planned recess in July. There is an urgent need to settle all these issues. Mongolia would be more than willing to accept suggestions and even change laws, if

companies are willing to use modern equipment and not harm the environment. Both sides need to work to better understand each other's position. The companies should respect Mongolia sovereignty, he said. Nyamdorj said that when the demonstrators had first begun raising these issues, he hadn't taken their claims seriously. Then, upon looking more closely, he had realized there are major problems. Hopefully, Mongolia would soon pass legislation to provide a good new legal environment, and one which would allow foreign mining companies to make profits. He said he understood the need to do this as quickly as possible.

Speaker Cites Weak Bank of Mongolia Management

¶15. (SBU) Regarding the Bank of Mongolia, the Speaker said he had set up a SGH working group to review the matter. The law on central banking, which had been adopted in the early 1990s, is being reviewed and might be amended. This year, there would be leadership changes at the bank; he opined that the bank's management was weak. He said he also felt that oversight of the bank needs to be looked at. He had hoped the IMF team that had just visited would make good recommendations, but he was disappointed. The two IMF recommendations were either unacceptable or unhelpful: one, that the SGH amend the banking law to prohibit the government from dipping into the central bank reserves as it did to pay off the Russian debt in 2003 and, two that the membership of the supervisory committee of the Bank should be expanded. He did not accept the first point. The money in the bank was owned by the people of Mongolia, and the State Great Hural had viewed it as the responsibility of Mongolia to settle its debt with Russia. He did not accept criticism on this issue. He had been looking for constructive IMF suggestions on how to take steps to improve the structure of the bank. He was now waiting for the working group's report and would then take a look at supervision.

Speaker Hopes for Anti-Corruption Law, AML By July

¶16. (SBU) Regarding the anti-corruption law and anti-money laundering law, he said, he expected the State Great Hural will be able to pass these during its spring session. Standing Committee work on the anti-corruption law would hopefully begin next week. Tax reform had already passed its first reading, and more work would be done during this week. After both these

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laws had passed, the SGH would take up the anti-money laundering laws. He repeated that he wanted the SGH to pass all four laws he had mentioned before it adjourns.

SLUTZ